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A.1 OPENNESS OF GOVERNMENT TO FOREIGN INVESTMENT

In its specific policies, laws, and general attitude, the Government of Mongolia (GOM), supports foreign direct investment (FDI) in all sectors and businesses. Its industrial and economic strategies do not discriminate actively or passively for or against foreign investors. Mongolia screens neither investments nor investors, except in terms of the legality of the proposed activity under Mongolian law.

Mongolian law does not discriminate against foreign investors. Foreigners may invest with as little as US$100,000 cash or the equivalent value of capital material (office stock, structures, autos, etc.). In both law and practice, foreigners may own 100% of any registered business with absolutely no legal, regulatory, or administrative requirement to take on any Mongolian entity as a joint venture partner, shareholder, or agent. The only exceptions to this flexible investment regime are in land ownership, petroleum extraction, and strategic mineral deposits.

Limitations on Participation in Real Estate, Petroleum Extraction, and Strategic Minerals Deposits

Only individual Mongolian citizens can own real estate. Ownership is currently limited to urban areas in the capital city of Ulaanbaatar, the provincial capitals, and the county seats, or soums. No corporate entity of any type, foreign or domestic, may own real estate. However, foreigners and Mongolian and foreign firms may own structures outright and can lease property for terms ranging from three (3) to ninety (90) years.

Mongolian law also requires oil extraction firms to enter into production sharing contracts with the government as a precondition for both petroleum exploration and extraction.

In 2006, the Mongolian Parliament (State Great Hural, or SGH) amended the 1997 Minerals Law of Mongolia. In doing so, it enacted the concept of the strategically important deposit. The amendments gave the Government of Mongolia (GOM) the right to obtain up to a 50% share of any mine on such a deposit. The 1997 law had no concept of "strategic deposits" or state equity in mines.

The 2006 amended law defines "mineral deposit of strategic importance" as "a mineral concentration where it is possible to maintain production that has a potential impact on national security, economic and social development of the country at national and regional levels or deposits which are producing or have potential of producing above 5% of total GDP per year." Ultimately, the power to determine what is or is not a strategic deposit is vested in the State Great Hural (SGH). For practical purposes, the GOM currently seems to define these deposits as world class copper and coal reserves and all deposits of rare earths and uranium.

If a mineral deposit is determined to be strategic and if the state has contributed to the exploration of the deposit at some point, the GOM may claim up to 50%. This applies to all exploration conducted during the socialist era, primarily by Soviet geologists. If the deposits were developed with private funds and the GOM has not contributed to the exploration of the deposit at any time, it may acquire up to 34% of the deposit.

State participation (or share) is determined by an agreement on exploitation of the deposit considering the amount of investment made the state; or, in the case of a privately-explored strategic deposit, by agreement between the state and the firm on the amount invested by the state. The SGH may determine the state share using a proposal made by the government or on its own initiative using official figures on minerals reserves in the integrated state registry.

It is important to note that the state equity provision does not seem expropriatory on its face as the GOM has committed itself to compensating firms for the share it takes at fair market value. Although experience is limited with the new law, so far the GOM has honored this commitment.

Windfall Profits Tax on Copper and Gold

The Windfall Profits Tax Law of 2006 (WPT) has drawn criticism regarding the GOM's commitment to creating an open, predictable, and fair environment for foreign direct investment. The speedy legislative process for passing the WPT was unprecedented. This bill was passed in six days without any consultation with outside stakeholders on any its provisions. The entire process has raised concerns among investors about the stability and transparency of Mongolia's legislative and regulatory environment.

In May, 2006, the SGH the WPT in an effort to: 1) assuage wide-spread public fears that Mongolia was being stripped of its mineral assets and 2) to increase revenues for new social spending on pensions and children.

The WPT imposes a 68% tax on the profits from gold and copper mining respectively. The WPT for gold originally kicked in when gold the price for gold hit US$500 per ounce; however, in late 2008 Parliament raised the threshold to US$850. For copper, the threshold is US$2,600 per ton. Mining industry sources claim that the 68% tax rate, when combined with other Mongolian taxes, makes the effective tax 100% on all proceeds above the copper threshold price. In theory, the WPT proceeds are set aside in a special fund for a combination of social welfare expenditures and a reserve fund.

Revisions of the Mongolian Tax Code

Problems with the WPT aside, major reforms to the Mongolian Tax code in 2006 were designed to improve the business environment in Mongolia for both foreign and domestic investors. Before the reforms, a World Economic Forum survey of Mongolian business executives cited tax rates and the complexity of tax regulations as two of the top five problems for doing business in Mongolia. The tax reforms benefited from two years of technical assistance from USAID's Economic Policy Reform and Competitiveness Project (EPRC). The reforms affected the Personal Income Tax (PIT) and Corporate Income Tax (CIT) codes, as well as the VAT and excise tax codes.

(EPRC has a number of useful and informative guides on their website: http://www.eprc-chemonics.biz.)

The old corporate income tax system's lack of a loss carry-forward provisions as well as arbitrary caps on deductions for business expenses discouraged investment; businesses could easily end up owing tax, even if they lost money. The old law was so at variance with world norms that it was a prime reason why foreign investors sought tax holidays under stability agreements.

The new laws became effective January 1, 2007. In general, the new laws reduce tax rates, flatten the tax schedule, remove discriminatory loopholes and exemptions, and introduce appropriate deduction opportunities for corporate investment.

The new corporate income tax law allows firms loss carry-forward for two years after incurring the loss, potentially encouraging investment and accommodating firms experiencing temporary negative shocks. While most businesses approve of this provision, many note that the two year carry-forward limit is insufficient for projects with long development lead times, as is typical of most large-scale mining developments. The new law allows firms to deduct more types of legitimate business expenditures: training, business travel, cafeteria expenses, etc. The new law levels the playing field between foreign and domestic investors, eliminating the majority of discriminatory tax exemptions and holidays (most of which favored international investors).

Unfinished Business (Including Customs Rates)

There is unfinished business, however. Parliament was scheduled to take up additional tax reform measures in 2007 but has not done so and has made no substantive progress since. These measures include revisions to the law on customs and customs tariffs. While the exact nature of the proposed changes in the customs law has been murky, the GOM states that changes will be consistent with Mongolia's WTO obligations and investment climate enhancement goals.

Despite overall solid, positive changes, international financial

institutions warn that last year's tax reforms by themselves are insufficient to improve Mongolia's business environment. They report that reform efforts need to go beyond changes to the tax code to restructure the operations of the key agencies - the tax department, the customs administration and the inspections agency - that directly interact with private firms and individuals.

2006 Amendments to the Law on State Procurements

Amended in late 2006, the revised Law on State Procurement (LSP) has two provisions that raise investor concerns. First, the new LSP bars international competitors from participating in government procurements under US$10 million, which covers 999 of the 1,000 projects budgeted for fiscal year 2007. The old law set a much lower bar for participating in state procurements of about US$1 million. In addition, the amended law specifically exempts power and transport projects from competitive procedures, as they were under the terms of the old law. In these two sectors, ministries may procure the services for the GOM by direct contracting for projects under US$10 million and where local capacity is lacking.

Issues in the Telecom and Aviation Sectors

While the Mongolian government supports FDI and domestic investment, domestic and foreign investors report that individual agencies and elements of the judiciary often use their respective powers to hinder investments into such sectors as meat production, telecommunications, aviation, or pharmaceuticals. Investors report similar abuses of inspections, permits, and licenses by Mongolian regulatory agencies.

Abuses in Mongolia's telecom and information technology sector have raised public and business concerns. The state-owned telecom company, Mongol Telecom (MT) uses its regulatory and technical clout to forestall or attack competition. As the monopoly supplier of

land-based lines through which much internet traffic flows, MT charges predatory rates for access to all other Internet Service Providers (ISPs) at a rate 10 times the charges assessed to the state-owned ISP. These per-minute charges add up and are hard for competitor ISPs to absorb. In addition, the GOM, in an effort to make Mongol Telecom more attractive for privatization, is inclined to make MT the sole portal for all telecommunication into Mongolia. The apparent intent here is to require licenses for both telecommunication services and technology, which only MT could satisfy. There has been significant lobbying against this policy by ISPs, voice-over IP providers, cellular rights holders, multi-lateral organizations, and diplomatic missions as contrary to Mongolia's own competition law and long-term interests. So far these efforts have delayed the passage of any damaging legislation.

Compounding these problems are the non-transparent activities of the Mongolian Information and Communication Technology Agency (ICTA), which is charged with providing policy guidance to the Communication Regulatory Commission of Mongolia (CRC). Companies report that this agency routinely embarks on maneuvers that seem to have no basis in law or regulation but that have hurt American interests, not to mention those of other investors. For example, ICTA has attempted to order internet service providers to charge set access prices, without recourse to the market. Most recently this government intervention has taken the form of setting floor prices for hook up charges on wireless, voice over IP, etc., but without setting ceiling prices for charges. The four big cellular providers dominating the market favor this approach because it protects their respective market shares. However, competitors cannot offer similar services at a price that might undercut the market leaders, harming and limiting consumers' rights to low cost communication alternatives.

ICTA has justified these acts by claiming that these low-cost providers would have offered services at such low prices that the dominant Mongolian cellular providers would have been driven out business, thus depriving the state of the benefits of cellular service.

The state also involves itself in the domestic aviation sector. Mongolia has two domestic service providers, the privately owned Aero Mongolia and EZNIS. Government regulation recommends maximum ticket prices that airlines may charge for all domestic routes, but the law does not strictly forbid airlines from charging fees higher than the state carrier. However, the GOM frowns on domestic airlines that charge more for service. These state prices are well

below operating costs and inhibit the private carriers from charging a break-even fee. However, the private carriers seem to have decided to shake off GOM prohibitions and are charging rates that might yield profits and support safe and efficient flying arrangements.

State-owned MIAT formerly ran domestic operations which were heavily subsidized, primarily through its foreign routes. This state-subsidized competition with private carriers has inhibited investors from participating in the provision of private domestic service; and consequently limited the aviation products and services that U.S. firms might sell into the Mongolian market. . However, MIAT and the GOM have failed to upgrade the domestic air fleet, letting it slowly wither. This tacit policy seems to have opened the field for private investment into the aviation sector.

The Mongolian Judiciary and the Sanctity of Contracts

We find no concerted, systematic, institutional abuse specifically targeted at foreign investment. In the case of the judiciary-corruption aside (see A. 11 Corruption)-most problems arise from ignorance of commercial principles rather than antipathy to foreign investment. In principle, both the law and the judiciary recognize the concept of sanctity of contracts. However, the practical application of this concept lags, with both foreign and domestic investors reporting inconsistent enforcement of contracts by the judiciary. This inconsistency comes from the slow transition from Marxist-based jurisprudence to more market oriented laws and

judicial practices. Recent decisions in banking and land use cases in which contract provisions were upheld reflect a growing commercial sophistication among Mongolia's judges. As more judges receive commercial training and as Soviet era (1921-1990) jurists retire, we expect to see the gradual improvement of the entire judicial system.

Privatization Policies and Resistance of Mongolian firms to Foreign Investment

Privatization policies have actually favored foreign investment in some key industries, including banking and cashmere production. The bidding processes for privatizations and other tenders have generally been transparent, and after some legal disputes among the winners and losers lasting from late 2006 through mid-2008, most participants have accepted the results.

Foreign companies and investors are subject to the same legal regime imposed on Mongolian domestic firms regarding incorporation and corporate activities For example, casinos are illegal under Mongolian law, and so, neither Mongolians nor foreigners may own or operate them (except in one specifically designated free trade zone).

Generally, Mongolian private businesses want foreign participation in all sectors of the economy. They seek foreign partners and equity. That said, some Mongolian businesses use Mongolian institutions to stop competitors, if they can. These activities represent no animus against foreign investment as such; rather, they reflect individual businesses desire to keep competitors, Mongolian or foreign, at bay.

Key Investment Laws

The Foreign Investment Law of Mongolia (FILM) transformed the anti-business environment of the Soviet era into today's investor-friendly regime. Under the old system, everything not provided for in law was illegal. Because such economic activities as franchising, leasing, joint venture companies were not specifically mentioned in earlier Mongolian statutes, they were technically illegal. In 1993, the GOM enacted FILM to legalize all manner of foreign investment in Mongolia (amended in 2002 to allow for representative offices and franchises). This law and subsequent amendments define broad ranges of activity that would otherwise have limited validity under Mongolian law. It also defines the meaning of foreign investment under the civil code without limiting activities that foreign investors can conduct. FILM also establishes registration procedures for foreign companies. Specifically, the law requires that any investment with 25% or more of foreign content must register as a foreign-invested firm with the government. The law creates a supervisory agency, the Foreign Investment and Foreign Trade Agency (FIFTA), that runs the registration process, liaises

among businesses and the Mongolian government, and promotes in- and out-bound investments.

In 2008, the Parliament of Mongolia amended the FILM. The stated intent of the revision was to improve FIFTA's ability to track foreign investment and to enhance the services provided by FIFTA to foreign investors. The amendments apply only to investments registered after the new law came into force in summer 2008. The new law has raised the minimum level for new foreign investment from US$1,000 to US$100,000 and imposed a series of requirements on foreign investors seeking registration. Registered foreign companies must now have FIFTA certify that their by-laws, environmental practices, their technologies, etc., comply with standards determined by FIFTA.

FIFTA officials admit that procedures are still under development and that because they lack specific expertise in most of these areas, they will have to consult with the relevant ministries and agencies as they assesses each firm's request for investment registration. FIFTA has also not clearly defined what the precise processes it will use to evaluate investments, what the exact standards will be for any given investment, how it will determine

those standards, and how an investor might seek redress if FIFTA denies a registration request. Foreign investors have expressed concern over what they perceive as FIFTA's broad and seemingly un-transparent regulatory authority; however, we have not received any complaint of abuse of these new powers to date.

New Ministerial Structure Impacts Foreign Investment
In early 2009, the Parliament re-organized the government structure by combining various ministries and agencies in an effort to streamline government functions. Relevant to foreign investors, Parliament took trade policy and trade promotion functions that had been vested in the former Ministry of Industry and Trade and FIFTA respectively and merged them with the Ministry of Foreign Affairs. The new Ministry of Foreign Affairs and Trade (MOFAT) has assumed direct control all formulation and execution of trade policies and promotion efforts, which includes export promotion and in-bound investment efforts. FIFTA is now under MOFAT's direct supervision.

Ministry officials have stated that the government will concentrate on promoting Mongolian exports and foreign investment into Mongolia. They want FIFTA to resemble counterpart agencies in South Korea, Japan, or the U.S.; and have told both us and businesses that they plan to get FIFTA out of the regulatory business. The intent is to limit FIFTA's activities to supporting business in their efforts to work in Mongolia and to registering in-bound investment for purposes of investment tracking only.
A.2 CONVERSION AND TRANSFER POLICIES

The Mongolian government employs a limited regulatory regime for controlling foreign exchange for investment remittances and maintains exceptionally liberal policies for these transactions. Foreign and domestic businesses report no problems converting or transferring investment funds, profits and revenues, loan repayments, lease payments into whatever currency they wish to wherever they wish. There is no difficulty in obtaining foreign exchange, whether the investor wants Chinese Renminbi, Euros, English Pounds, Rubles, or U.S. Dollars. The ongoing global financial crisis has made dollars scarcer, with banks and individuals reporting difficulties in exchanging into the currency. This currency shortfall, however, appears to have occurred because of challenging economic circumstances rather than policy changes.

The Mongolian government wants funds to flow easily in and out of the nation, with one exception. Foreign-held interest bearing dollar accounts remain subject to a 20% withholding tax. The bank retains 20% of all such interest payments sent abroad, and remits this withholding to the Tax Authority of Mongolia. Otherwise, businesses report no delays in remitting investment returns or receiving in-bound funds. Most transfers occur within 1-2 business days or at most a single business week.

Ease of transfer aside, foreign investors criticize Mongolia's lack of sophisticated mechanisms for converting currencies and parking money. Letters of credit are difficult to obtain, and legal parallel markets do not exist in the form of government dollar denominated bonds or other instruments for parking funds in lieu of payment. Many Mongolian financial institutions lack experience with these arrangements. Moreover, Mongolian banking law currently

provides no secure statutory grounds for the activity to take place. Banks may hesitate to use instruments that may be technically illegal under Mongolian law. The immediate impact has been to limit access to certain types of foreign capital, as international companies resist parking cash in Mongolian banks or in local debt instruments.
A.3 EXPROPRIATION AND COMPENSATION

Mongolia respects property rights as they apply to most asset types. We detect no changes in policies, statutes, or regulations related to the use and ownership of private property. Foreigners face no legal bias in asset ownership (except that only citizens of Mongolian may own land) or how they structure ownership. Foreign investors need not seek local partners or share ownership of most assets or endeavor as a condition of doing business. However, in the crucial mining sector, with extensive foreign participation,

some note governmental actions that might represent "creeping expropriation" coupled more broadly with some renewed "statist tendencies," meaning gradual increases in government ownership of and participation in Mongolia's economy.

Security of Ownership

Mongolia and the United States signed and ratified a Bilateral Investment Treaty (BIT) which entered in force in 1997, and which specifically enjoins both signatories from expropriatory acts against private property and investments. In addition, both Mongolian law and the national constitution recognize private property and use rights and specifically bar the government from expropriation of such assets. To date, the government of Mongolia (GOM) has not expropriated any American property or assets. Thus, we have no precedent from which to assess how the Mongolian system would respond to seizure and compensation.

As can most governments, the Mongolian government can claim land or restrict use rights in the national interest. Currently, this means little, as most land outside Mongolia's urban centers remains government property, as provided in Mongolia's constitution. The government has no plans to privatize these vast countryside holdings, but it leases parcels for such economic activities as mining, pasturage, timbering, etc. This practice remains in flux because the government must still determine how to let these rights and what fees to charge. Except for mining, most foreign firms remain inactive in these sectors.

Since May 2003, land in the urban areas has been privatized to citizens of Mongolia or leased to both citizens and foreigners for periods ranging from 3-90 years. The legislation and implementing regulations are evolving, but so far investors believe that the GOM generally respects recently enacted property rights and leases.

I: Implications of the Current Minerals Law

We closely watch the key mining sector, Mongolia's major foreign exchange earner. The 2006 amendments to the Minerals Law have several provisions that raise red flags for investors and observers alike. The law does not allow the GOM to usurp rights to explore and exploit natural mineral, metal, and hydrocarbons resources per se. Instead, the amended law has imposed new procedural requirements and extends new powers to central, provincial, and local officials - new powers that, if abused, might prevent mineral's license holders from exercising their exploration or mining rights. The current law has the potential to deny the rights holder access to his rights without formally revoking use rights. .

An example is the new tender process for apportioning some exploration rights. The old law awarded exploration rights on a "first come, first served" basis, a process that gave little discretion to government officials to intervene. The new law lays out a different procedure for obtaining exploration rights on land explored with state funds or lands where the current holder has forfeited exploration rights. The Mineral Resources Authority of Mongolia (MRAM) will tender such exploration rights only to firms technically qualified to conduct minerals work. The new tender procedure neither requires nor allows for a cash-bid. Only the technical merits of exploration proposals will determine who gains exploration rights. MRAM staff has the authority and responsibility to assess the merits of proposals to determine who wins the tenders.

Both MRAM and its supervising authority, the Ministry of Mineral Resources and Energy, now have broad discretionary authority to select who will get tenements. This authority disturbs miners, who fear this power will be the source of corruption and arbitrary decisions by MRAM. Evidence suggests that local mining guilds will define an expert in Mongolian mining as a person who received a degree from a Mongolian institution, such as the National University, rather than an internationally recognized institution. While this enforced employment program for Mongolian geologists would be an annoyance, the discretionary power MRAM now has

generated the most concern. If MRAM rejects a firm's experts and mining plan as unqualified, no recourse is spelled out under the new law, and the firm will in effect lose its rights.

The concept of "expertise" allows another potential avenue for expropriation of rights by denying or preventing their use. The law has the potential to limit the ability of rights holders to seek financing, because it forbids transfer of mining licenses and exploration rights to non-qualified individuals. Consequently, a miner will not be able to offer his licenses as secured collateral to banks or to any lender lacking the professional qualifications to receive these rights if the miner defaulted on his debt obligations. A given bank is unlikely to set up a "qualified" mining firm just to receive a pledged license offered as collateral. Thus, the law limits the investment pool that a mining firm might tap to finance its mine, which might prevent bringing a property into production, again denying licensees access to their legal economic rights.

The amended law removes the Mongol word for exclusive from the grant of exploration rights. The old article read, "To conduct exclusive exploration for minerals within the boundaries of an exploration area in accordance with this law." The new article reads, "To conduct exploration for minerals. . . ." It is unclear what, if anything, this deletion means. However, the deletion would seem to allow the government to apportion mineral rights per metal or mineral rather than as a whole, which has been the standard practice. The deletion was done intentionally, as the word appeared in earlier drafts, right up to the passage of the law.

Investors and observers are also concerned about new authority granted to the MRAM Chairman to approve transfers of existing and new licenses. The law grants final approval authority to the MRAM, without specifying any check or balance on this official's authority. This power is not a revocation but if abused would certainly prevent exercise of economic rights.

Complicating matters is that in early 2009 MRAM had been moved under the direct authority of the Ministry of Mineral Resources and Energy in a sweeping re-organization of the government. Prior to this restructuring, MRAM had been a quasi-independent agency, the acts of which did not require ministerial approval. In the new structure, the ministry can intervene in the registration and transfer of exploration and mining licenses. The ministry seems to have only intervened in cases where the license involves a "strategic" deposit. (See A.1 Openness to Foreign Investment for explanation of strategic deposits.) In this specific category, ministerial officials have ordered MRAM to freeze all transfers and transactions involving properties near or in strategic deposits, which includes uranium deposits of any size and massive coal and copper deposits near the Chinese border. Further, these same officials have indicated that the government may then revoke the rights of those holding exploration rights or mining licenses in or near strategic deposits. Although the law seems to allow for compensation, the ministry has not presented formal compensation packages to those potentially affected by its actions.

Acts of Provincial Administrations:

With regard to the issuance of both exploration permits and mining licenses, provincial officials increasingly appear to use their authority to block arbitrarily access to mining rights legally granted under the current law. For example, reports regularly circulate that some provincial government officials abuse their authority to designate land as "special use zones" to usurp mining exploration tenements. In a common technique, provincial governors often reclassify property that has never felt the touch of the plow or felt the tread of a tourist for agricultural use or cultural tourism respectively, although the central government has legally granted exploration rights to miners. In one case, a miner could not gain access to the subsurface resources because the provincial

government claimed that doing so would damage a potato farm that had suddenly appeared over the site.

Other miners harshly criticize the misuse of the local officials'

rights to comment on permits for water use and mining licenses. Comments are advisory, and have limited legal force regarding disallowing activity, but the central government routinely hesitates to reject a governor's negative comment no matter the motives behind it. The effect has been to stop progress for months, limiting access to the resource and costing rights holders' time and money.

Whatever the motives, these provincial actions are often seen as a creeping bureaucratic expropriation through denial of access and use rights. The 2006 Minerals Law provides no clear limit on provincial control of permits and special use rights or guidance on how to apply these powers beyond codifying that the provincial and local authorities have some authority over activities occurring in their provinces and soums (counties). Faced with these unclear boundaries of authority, the central government often interprets the rules and regulations differently from the provincial authorities, creating administrative conflicts among the various stakeholders. The central government acknowledges the problematic ambiguity but has yet to definitively clarify the situation in law or practice, even though the situation threatens accessing one's rights. Mongolian and foreign permit holders have advised the government that letting this problem fester raises perceptions among investors that they may risk losing their economic rights, which can scare away inbound investors.

A.4 DISPUTE SETTLEMENT

The GOM consistently supports transparent, equitable dispute settlements, but executing good intentions has proven problematic. These problems come from a lack of experience with standard commercial practices rather than from any systemic intent by public or private entities to target foreign investors. The framework of laws and procedures is functional, but many judges who adjudicate disputes remain ignorant of commercial principles.

Problems with Dispute Settlement in Mongolia's Courts

The court structure is straightforward and supports dispute settlement. Disputants know the procedures and the venues. Plaintiffs bring cases at the district court level before a single district judge or panel of judges, depending on the complexity and importance of the case. The district court renders its verdict. Either party can appeal this decision to the Ulaanbaatar City Court, which rules on matters of fact as well as matters of law. It may uphold the verdict, send it back for reconsideration or nullify the judgment. Disputants may then take the case to the Mongolian Supreme Court for a final review.

Problems arise for several reasons. First, commercial law in Mongolia and understanding of it are in flux. New laws on contracts, investment, corporate structures, leasing, etc. have been passed or are being considered at both the ministerial and parliamentary levels. Mongolian civil law does not work on precedents but from application of the statute as written. If a law is vague or does not cover a particular commercial activity, the judge's remit to adjudicate can be severely limited or non-existent. For example, until recently leasing did not exist in the Mongolian civil law code as such, but seemed to be covered under various aspects of Mongolian civil law regarding contracts and other agreements. But judgments on leasing made under these laws might not have applied to an arrangement not otherwise specifically recognized under its own exclusive law. Further, because precedents are not legally relevant or binding on other judges and Mongolian courts, decisions reached in one case have no legal force in other suits, even when the circumstances are similar or even before the same court and judges.

Trained in the former Soviet era, many judges lack training in or remain willfully ignorant of commercial principles. They dismiss such concepts as the sanctity of the contract. This is not a problem of the law, which recognizes contracts, but of faulty interpretation. In several cases courts have intentionally misinterpreted provisions regarding leases and loan contracts. Judges regularly ignore terms of a contract in their decisions. If someone defaults on a loan, the courts often order assets returned without requiring the debtor to compensate the creditor for any loss of value. Judges routinely assert that the creditor has recovered

the asset, such as it is, and that is enough. Bad faith and loss of value simply do not enter into judicial calculations of equity.

Replacing old-school judges is not an option. It is politically impossible-if not functionally impractical-for the Mongolians to dismiss this cadre of Soviet-era judges. There is a realistic hope that young justices, trained in modern commercial principles by American and European experts, will gradually improve judicial protections for commercial activities in Mongolia. Lately, we have seen better decisions in several cases involving Americans seeking to recover on debts and contractual fees and to hold Mongolian government entities to the terms of their respective contracts and regulations, but these results tend to be limited to courts where modern-educated judges preside.

Bankruptcy and Debt Collection

Mongolia's bankruptcy provisions and procedures for securing the rights of creditors need serious reform. Mongolian law allows for mortgages and other loan instruments backed up with securitized collateral. However, rudimentary systems for determining title and liens and for collecting on debts make lending on local security risky. Banks frequently complain that onerous foreclosure rules are barely workable and unfair to the creditor.

Although a system exists to register immovable property-structures and real estate-for the purpose of confirming ownership, the current system does not record Qting liens against immovable property has. In addition, no system exists to record ownership of, and liens on, movable property. Consequently, Mongolian lenders face the added risk of lending on collateral that the debtor may not actually own or which may have already been offered as security for another debt.

Overall, the legal system does recognize the concept of collateralized assets provided as security for a loan, investment capital, or other debt-based financial mechanism. The legal system also provides for foreclosure, but this process has proved exceptionally onerous and time consuming. A 2005 change to Mongolian law simplified the process by allowing creditors to foreclose without judicial review. Prior to the new law, all creditors had to go to court to collect on securitized collateral, thus adding months to the entire collection process. However, the Constitutional Court of Mongolia voided the law on constitutional grounds, slowing down debt collection to pre-2005 levels. Waits of up to 24 months for final liquidations and settlement of security are not uncommon.

Once a judgment is rendered, the disputant faces a relatively hostile environment to execute the court's decision. For example, a bank collecting on a debt in Mongolia must allow debtors to put forward assets for auction and set the minimum bid price for those assets. If assets do not sell, a second round of auctions occurs in which a reduced minimum bid is put forward. The State Collection Office (SCO) supervises this process but does not set the price. However, the SCO receives 10% of the sales price, or of the second auction minimum price even if there is no sale.

The SCO does not allow collateralized assets to be valued by neutral 3rd parties. Because it derives income from the forced sale of assets, the SCO has a conflict of interest; and, anecdotally, seems to have failed as an impartial arbiter between debtors and creditors. For banks, this has meant that forcing a company into bankruptcy may be the safest way to recover rather than forcing piecemeal sales of assets. This approach automatically puts all assets into play rather than those selected by the debtor. However, it is an onerous procedure without a clear process behind it.

Purchase financing is also tricky. For example, a local car dealer financed an auto for US$20,000 down and US$60,000 in credit, complete with a local bank guarantee. The buyer subsequently defaulted on the loan, the bank refused to honor its guarantee, and the dealer took the buyer to court. Under current Mongolian law, interest payments are suspended for the duration of the case, from first filing to final appeal before the Supreme Court of Mongolia. Possibly months of interest-free time can pass while the asset rusts

in an impound lot. In this case, the dealer simply reclaimed the car and dropped the lawsuit, swallowing the lost interest payments and loss in value on the car. Domestic and foreign businesses often respond by requiring customers to pay in cash, limiting sales and

the expansion of the economy.

Binding Arbitration: International and Domestic

The Mongolian government supports and will submit to both binding arbitration and international settlement procedures. However, glitches remain in local execution. Mongolia ratified the Washington Convention and joined the International Centre for Settlement of Investment Disputes in 1991. It also signed and ratified the New York Convention in 1994.

To our knowledge, the government of Mongolia has accepted international arbitration in four disputes where claimants have asserted the government reneged on a sovereign guarantee to indemnify them. In all cases the government has consistently declared that it would honor the arbitrators' judgments. However, this resolution has not been put to the test, as Mongolia has won each case.

More widely, Mongolian businesses partnered with foreign investors accept international arbitration, as do government agencies that contract business with foreign investors, rather than avail themselves of the Arbitration Bureau operated by the Mongolian National Chamber of Commerce and Industry. They seek redress abroad because they perceive that domestic arbitrators are too politicized and self-interested to render a fair decision.

Although arbitration is widely accepted among business people and elements of the government, support for binding international arbitration has not penetrated local Mongolian agencies responsible for executing judgments. In two cases, the Mongolian-state-owned copper mine lost two international arbitral cases. The awards were certified and recognized as valid and enforceable by Mongolian courts. But the local bailiff's office has consistently failed to execute the collection orders. Local business people routinely cite the failure of SCO and the bailiffs to enforce court-ordered foreclosures and judgments as the most common problem threatening resolution of debt-driven disputes.
A.5 PERFORMANCE REQUIREMENTS AND INCENTIVES

Mongolia imposes few performance requirements on, and offers few incentives to, investors. The few requirements imposed are not onerous and do not limit foreign participation in any sector of the economy. Performance requirements are applied somewhat differently to foreign investors in a limited number of sectors.

2006 Amendments to the Tax Law of Mongolia did away with most tax incentives and exemptions. (Certain staples, such as flour, and sectors targeted for growth, most recently, the agriculture sector, have and continue to receive exemptions on import duties and on Mongolia's value-added tax.) The GOM seems willing to let current agreements run their course. Foreign investors have accepted phasing out of tax incentive provisions since the amendments bring other world-standard practices to the tax code. These include provision for loss-carry-forwards, five-year accelerated depreciation, and more deductions for legitimate business expenses including but not limited to marketing and training expenses.

Few Restrictions on Foreign Investment

The government applies the same geographical restrictions on both foreign and domestic investors. Existing restrictions involve border security, environmental concerns, or local use rights. There are no onerous or discriminatory visas, residence, or work permits requirements imposed on American investors. Generally, foreign investors need not use local goods and services, local equity, or engage in substitution of imports. Neither foreign nor domestic businesses need purchase from local sources or export a certain percentage of output, or have access to foreign exchange in relation to their exports.

Although there remains no formal law requiring the use of local goods and services, the GOM encourages firms to do value-added production in Mongolia, especially for firms engaged in natural resource extraction. Certain senior officials and politicians have made in-country processing a consistent feature of their public and private policy statements regarding the development of mining. For example, the 2006 windfall profits tax on copper and gold applies the tax to copper concentrate, but exempts metallic copper produced in Mongolia. Recent negotiations on strategic copper deposits in

the Gobi between the GOM and private Western firms ended with commitments by the companies to explore copper smelting in Mongolia. Government talks on coal production constantly feature discussions of power generation and coals-to- liquid processing in Mongolia. The recently-passed Government Action Plan also calls for increased investment in businesses and activities that keep the "value" of a resource in Mongolia. As a result, firms should continue to expect the GOM to aggressively press them for value-added production in Mongolia.

Generally, foreign investors set their own export and production targets without concern for government imposed targets or requirements. There is no requirement to transfer technology. As a matter of law, the government imposes no offset requirements for major procurements. Certain tenders may require bidders to agree to levels of local employment or to fund certain facilities as a condition of the tender, but as matter of course such conditions are not the normal approach of the government in its tendering and procurement policies.

Investors may finance as they see fit. Foreign investors need sell no shares to Mongolian nationals. Equity stakes are generally at the complete discretion of investors, Mongolian or foreign. Investors, not the Mongolian government, make arrangements regarding technology, intellectual property, etc.

Regarding employment, investors can locate and hire workers without using hiring agencies-as long as hiring practices are consistent with Mongolian Labor Law. However, Mongolian law requires companies to employ Mongolian workers in certain labor categories whenever a Mongolian can perform the task as well as a foreigner. This law generally applies to unskilled labor categories and not areas where a high degree of technical expertise not existing in Mongolia is required. The law does provide an escape hatch for all employers. Should an employer seek to hire a non-Mongolian laborer and cannot obtain a waiver from the Ministry of Labor for that employee, the employer can pay a fee of around US$140 per employee per month. Depending on the importance of a project, the Ministry of Labor may grant an employer a 50% exemption of the waiver fees as an incentive.

Limited Performance Requirements

Performance requirements are sparingly imposed on investors in Mongolia with the exception of petroleum and mining exploration firms. The Petroleum Authority of Mongolia (PAM) issues petroleum exploration blocks to firms, which then agree to conduct exploration activities. The size and scope of these activities are agreed upon between PAM and the firm in writing and are binding. If the firm fails to fulfill exploration commitments, it must pay a penalty to PAM based on the amount of hectares in the exploration block, or return the block to MPPAM. These procedures apply to all investors in the petroleum exploration sector.

The 2006 amendments to the Minerals Law of Mongolia made receiving and keeping exploration licenses contingent on conducting actual exploration work. Under the terms of the 1997 Minerals Law, mining companies holding exploration tenements or extraction licenses needed neither explore nor mine so long as they paid annual fees associated with their holdings and provided annual reports of their activities to the government of Mongolia.

The amended law imposes more stringent work requirements. Each year and subject to annual verification by the Minerals Authority of

Mongolia (MRAM), exploration firms must submit a work plan and report on the execution of the previous year's performance commitments. Commitments expressed in terms of US dollar expenses per hectare per year:

--2nd and 3rd years miners must spend no less than US $.50 per hectare on exploration

--4th to 6th years miners must spend no less than US $1.00 per hectare on exploration

--7th to 9th years miners must spend no less than US $1.50 per hectare on exploration

MRAM has the authority and right to inspect the exploration sites to verify that work is being done. Failure to comply with work

requirements may result in fines, suspension, or even revocation of exploration rights.

In addition to these performance requirements, the law also requires holders of mining licenses for projects of strategic importance to sell no less than 10% of company shares on the Mongolian Stock Exchange. Vaguely presented in the statute, there is still no formal clarification in law or regulation of what this provision means in practical terms or how it is to be implemented.

All foreign investors must register with the Foreign Investment and Foreign trade Agency (FIFTA). The Foreign Investment Law of Mongolia requires all foreign investors to show a minimum of US$100,000 in assets (cash, working stock, property, etc.) registered in Mongolia as a precondition for registration. In addition to this particular requirement, all foreign investors must pay an initial processing fee of some 12, 000 Mongolian tugriks or about US$8.00. Foreign Investors must then pay a yearly prolongation fee of 6,000 Mongolian tugrik or about US$4.00.

In addition to these fees, foreign investors must annually report on their activities for the coming year to the government through FIFTA. Businesses need not fulfill plans set out in this report, but failure to report may result in non-issuance of licenses and registrations and suspension of activities. This requirement differs from that imposed on domestic investors and businesses. Local investors do not have a yearly reporting requirement. Mongolians pay lower registration fees, which vary too much to say with any precision what the fees actually are.

FIFTA explains that the higher registration costs for foreign investors arise from the need to compensate for the services it provides to foreign investors, including assistance with registrations, liaison services, trouble-shooting, etc. The different reporting requirements provide the government with a clearer picture of foreign investment in Mongolia. Foreign investors are generally aware of FIFTA's arguments and largely accept them, but they question the need for annual registrations. Investors recommend that FIFTA simply charge an annual fee rather than require businesses to submit a new application each year.

Regarding reports, foreign businesses are concerned about the security of their proprietary information. Several foreign investors have claimed that agents of FIFTA routinely use or sell information on business plans and financial data. We have yet to verify these claims, but FIFTA acknowledges that data security largely depends on the honesty of its staff, as there are few internal controls over access to the annual reports.

Tariffs

Mongolia has one of Asia's least restrictive tariff regimes. Its export and import policies do not harm or inhibit foreign investment. Low by world standards, tariffs of 5% on most products are applied across the board to all firms, albeit with some concerns about consistency of application and valuation. However, some non-tariff barriers, such as phyto-sanitary regulations, exist that limit both foreign and domestic competition in the fields of

pharmaceutical imports and food imports and exports. The testing requirements for drugs are extremely unclear and onerous. When companies attempt to clarify what the rules for importing food or drugs into the country are, they receive contradictory information from multiple agencies.

WTO TRIMS Requirements

Mongolia employs no measures inconsistent with WTO TRIMs requirements, nor has anyone alleged that any such violation has occurred.

A.6 RIGHT TO PRIVATE OWNERSHIP AND ESTABLISHMENT

Mongolia has one of Asia's most liberal ownership and establishment regimes. Unless otherwise forbidden by law, foreign and domestic businesses may establish and engage in any form of remunerative activity. All businesses can start up, buy, sell, merge; in short, do whatever they wish with their assets and firms.

Diminishing Competition from the State-Owned Sector

Mongolia passed and implemented a competition law applying to foreign, domestic, and state-owned entities active in Mongolia. As a practical matter, competition between state-owned and private businesses has been declining for the simple reason that most parastatals have been privatized. The exceptions are the state-owned power and telecom industries, an airline, the national rail system, several coal mines and a large copper mining and concentration facility.

Currently, three firms -- one a Mongolian company and the others Chinese state-owned entities -- are actively seeking opportunities for power generation. Few want to enter the power generation field until the regulatory and statutory framework for private power generation firms up and tariffs are set at rates allowing profits. In the railway sector, a recent law allows private firms to build, operate, and transfer railroads to the state. Under this new law several private mining companies have proposed rail links from their respective coal mines to the Chinese border or to the currently operating spur of the Trans-Siberian Railroad. Mongolia has no plans to privatize railroads jointly held with the government of Russia.

Although the trend has been for the GOM to extract itself from ownership of firms and other commercial assets, the current Minerals Law of Mongolia lets the state back into mining. Under this law, the GOM gained the right to acquire equity stakes of up to 50% in certain deposits that it deems of strategic value for the nation. Once acquired, these assets are to be placed with a state-owned management company, Erdenes MGL, that will invest them for the benefit of the Mongolian people. The role of state as an equity owner, in terms of management and operation of the mining asset, is unclear at this point. There is some concern that the GOM will have to deal with conflicts of interest arising from its dual position as regulator and owner of these strategic assets. Specifically, firms are worried that the GOM's desire to maximize returns in order to provide a revenue stream to the Mongolian people may comprise the long term commercial viability of any mining project.

A.7 PROTECTION OF PROPERTY RIGHTS

The right to own private, movable and immovable property is recognized under Mongolian law. Regardless of citizenship (except for land which only citizens of Mongolia can own), owners can do as they wish with their property. One can collateralize real and movable property. Should a debtor default on such secured loans, the creditor does have recourse under Mongolian law to recover the debt by seizing and disposing of property offered as security. The only exceptions to this liberal environment are recent changes to the mining law that prevent transfer of exploration and mining licenses to third parties lacking professional mining qualifications.

Mongolia's Current Regime to Protect Creditors

The current protection regime for creditors is functional but needs reform. The legal system presents the greatest pitfalls. Although the courts recognize property rights in concept, they have a checkered record of protecting and facilitating acquisition and disposition of assets in practice. Part of the problem is ignorance of, and inexperience with, standard practices regarding land, leases, buildings, and mortgages. As noted in A.4 Dispute Settlement, some Soviet-trained judges, largely out of ignorance of the concepts, have failed to recognize these practices. Newly trained judges are making a good faith effort to uphold property rights, and need time to learn how to adjudicate such cases.

Mongolia's bankruptcy provisions and procedures for securing the rights of creditors need serious reform. Mongolian law allows for mortgages and other loan instruments backed up with securitized collateral. However, rudimentary systems for determining title and liens and for collecting on debts make lending on local security risky. Banks frequently complain that onerous foreclosure rules are barely workable and unfair to the creditor.

Although a system exists to register immovable property-structures and real estate-for the purpose of confirming ownership, the current system does not record if immovable property has any liens against it. In addition, no system exists to record ownership and liens of movable property. Consequently, Mongolian lenders face the added

risk of lending on collateral that the debtor may not actually own or which may have already been offered as security for another debt.

Overall the legal system does recognize the concept of collaterized assets provided as security for a loan, investment capital, or other debt-based financial mechanisms. The legal system also provides for foreclosure, but this process has proven exceptionally burdensome and time consuming. A September 2005 change to Mongolian law simplified the process by allowing creditors to foreclose without judicial review. Prior to the new law, all creditors had to go to court to collect on securitized collateral, thus adding months and expense to the entire collection process. However, the Constitutional Court of Mongolia voided the law on constitutional grounds, slowing down debt collection to pre 2005 levels where waits of up to 24 months for final liquidations and settlement of security were not uncommon.

Debt Collection Procedures

However, even with the delays, getting a ruling is relatively easy compared to executing the court's decision. The problem is not the law but the enforcement. A judge orders the State Collection Office (SCO) to move on the assets of the debtor. The SCO orders district bailiffs to seize and turn those assets over to the state, which then distributes them to creditors. However, foreign and domestic investors claim that the state collection office and the district bailiffs frequently fail in their responsibilities to both the courts and the creditors.

In some cases, bailiffs refuse to enforce the court orders (see the Erdenet case mentioned in A.4). The perception is that they do so because they have been bribed or otherwise suborned. Bailiffs are often local agents who fear local retribution against them and their interests if they collect in their localities. In some cases, bailiffs will not collect unless the creditor provides bodyguards during seizure of assets. Creditors also have reason to believe that the state collection office accepts payments from debtors to delay seizure of assets.

Protection of Intellectual Property Rights

Mongolia supports intellectual property rights in general and has protected American rights in particular. It has joined the World Intellectual Property Organization (WIPO) and signed and ratified most treaties and conventions, including the WTO TRIPS agreement.

The WIPO Internet treaties have been signed but remained un-ratified by the State Great Hural, Mongolia's Parliament. However, even if a convention is un-ratified, the Mongolian government and its intellectual property rights enforcer, the Intellectual Property Office of Mongolia (IPOM), make a good faith effort to honor these agreements.

Under TRIPS and Mongolian law, the Mongolian Customs Authority (MCA) and the Economic Crimes Unit of the National Police (ECU) also have an obligation to protect IPR. MCA can seize shipments at the border. The ECU has the exclusive power to conduct criminal investigations and bring criminal charges against IPR pirates. The IPOM has the administrative authority to investigate and seize fakes without court order. Of these three, only the IPOM makes a good faith effort to fulfill its mandates.

Part of the problem is ignorance of the importance of intellectual property to Mongolia and of the obligations imposed by TRIPS on member states. Customs has been particularly hesitant to seize shipments, saying that their statutory mandate does not allow seizure of such goods, but Mongolian statutory and constitutional law recognizes that international treaty obligations take precedence over local statutes and regulations. A clear legal basis exists for Customs to act, which has been recognized by elements of the Mongolian Judiciary, the Parliament, and the IPOM. In any case, Customs officers do occasionally seize fake products, but it seems that Mongolian customs law will have to be brought into compliance with TRIPS before Customs will actively fulfill its obligations. The ECU has also been lax. The ECU hesitates to investigate and prosecute IPR cases, deferring to the IPOM as the lead agency. Anecdotal evidence suggests that ECU officials fear political repercussions from going after IPR pirates, many of whom wield political influence.

The IPOM generally has an excellent record of protecting American trademarks, copyrights, and patents. However, its small budget limits the scope of its actions. In most cases, when the U.S. Embassy in Ulaanbaatar conveys a complaint from a rights holder to the IPOM, the IPOM quickly investigates the complaint. If it judges that an abuse occurred, it will (and has in every case brought before it to date) seize the pirated products or remove faked trademarks, under administrative powers granted in Mongolian law.

We note two areas where enforcement lags. Legitimate software products are rare in Mongolia. Low per capita incomes have given rise to a thriving local market for cheap, pirated software. The IPOM estimates pirated software constitutes at least 95% of the market. The Office enforces the law where it can but the scale of the problem dwarfs its capacity to deal with it. The IPOM will act if we bring cases to their attention.

Pirated optical media are also readily available and subject to spotty enforcement. Mongolians produce no fake CD's, videos, and DVD's, but import such products from China, Russia, and elsewhere. Products are sold through numerous local outlets and sometimes broadcast on private local TV stations. The IPOM hesitates to move on TV stations, most of whom are connected to major government or political figures. Nor does the IPOM raid local ("street") DVD and CD outlets run by poor urban youth; IPOM argues that such action would not halt sales and only alienate the public. Again, when an American raises a specific complaint, the IPOM acts on the complaint, but IPOM rarely initiates action on its own.

2006 Amended Mining Law Restricts Transfer of Licenses in Certain Cases

The current Minerals law of Mongolia would seem on its face to prevent transfer of exploration or mining rights to any third party lacking professional mining qualifications as determined by the Mineral Resources Authority of Mongolia (MRAM).

Under the Minerals Law, the concept of mining expertise can either qualify or disqualify any entity from acquiring, transferring, securitizing exploration and mining rights. The law has the

potential to limit the ability of rights holders to seek financing, because it forbids transfer of mining licenses and exploration rights to non-qualified individuals. Consequently, a miner might not be able to offer his licenses as secured collateral to banks or to any lender lacking the professional qualifications to receive these rights if the miner defaulted on his debt obligations.

At a stroke the law seems to limit the investment pool that a mining firm might tap to finance its mine, which might prevent bringing a property into production, again denying licensees access to their legal economic rights.

A.8 TRANSPARENCY OF THE LEGISLATIVE AND REGULATORY PROCESS

Generally, Mongolia's problem is not lack of laws and regulations-Mongolia has passed more than 1,600 laws since undertaking its transition to a market economy over 18 years ago-but a lack of knowledge on the part of the lawmakers on what is needed and a history of not consulting with affected and potentially affected communities. Corruption aside, the fact that laws and regulations change without much consultation creates a chaotic situation for all parties. Many laws and regulations, as well as behavior, still require amendment and adjustment; but, overall, the trend is positive. We have seen definite improvement in the mining sector and in the foreign investment statutes.

Problems with the Drafting Process for Legislation and Regulations

Normally, laws can be crafted in two ways. Once rare but now more common, Members of Parliament and the President of Mongolia may draft their own proposals for direct submission to the Parliament. Such bills need not be submitted to the Cabinet of Ministers but can be delivered directly to the Speaker of Parliament for consideration by the relevant Standing Committee. The relevant Standing Committee may either reject the bill (in which case it dies in committee) or pass it on to the Parliament's plenary body, unaltered or revised for a general vote. More common is when Parliament or the Cabinet of Ministers requests legislative action. These institutions send such requests to the relevant ministry. The Minister relays the request to ministerial council, which in turn sends the request to

the proper internal division or agency within the respective ministry, which in turn forms a working group. The working group prepares the bill, submits it for ministerial review, makes any recommended changes, and then the bill is reviewed by the full Cabinet of Ministers. Relevant ministries are asked to comment and recommend changes in the legislation.

Prior to a final vote by the Cabinet of Ministers, the National Security Council of Mongolia (NSC)-consisting of the President of Mongolia, the Prime Minister, and Speaker of Parliament-can review each piece of legislation for issues related to national security. Although the legal and constitutional authority of the NSC to veto entirely, or to recommend changes to, draft legislation has not been clarified to outside observers, the Cabinet to our knowledge will not and has never overruled NSC recommendations.

Once through NSC and Cabinet reviews, the bill goes to Parliament. In Parliament, the bill is vetted by the relevant Standing Committee, sent back for changes or sent on to the full Parliament for a vote. The President can veto bills, but his veto can be overcome by a two-thirds (2/3) vote of Parliament.

For regulations, the process is truncated. The relevant minister assigns the task of writing the regulations to the working group that wrote the original law. This group submits their work to the minister who approves or recommends changes.

The Ministry of Justice and Home Affairs (MOJHA) plays an important role in drafting both laws and regulations. MOJHA vets all statutes and regulations before they are passed for final approval. In the case of legislation, MOJHA is supposed to reconcile the language and provisions of the law with both existing legislation and the constitution of Mongolia, after which the law is supposed to pass to the Cabinet and then Parliament. In the case of regulations, MOJHA

vets the regulations to ensure consistency with current laws and provisions of the constitution. In either case, MOJHA can, in effect, veto legal or regulatory provisions that it finds inconsistent with the statutes and constitution.

Absent from these drafting processes is a statutory, systematic, transparent review of legislation or regulations by stakeholders and the public. Ministerial initiatives are not publicized until the draft has passed out of a given ministry to the full Cabinet. Typically, the full Cabinet discusses and passes bills on to Parliament, without public input or consultations. Parliament itself issues neither a formal calendar nor routinely announces or opens its standing committee or full chamber hearings to the public. While Parliament at the beginning of each session announces a list of bills to be considered during the session, this is very general and often amended. New legislation is commonly introduced, discussed and passed without public announcement or consideration. For example, in 2006, Parliament passed the Wind Fall Profits Tax Law bill in six days without consulting any business, NGO, or other entity about the impact and desirability of the bill. In 2007, Parliament significantly amended the Law on State Procurement within thirty days without any public notification or comment regarding new limits competitive, transparent bidding practices and limits on access tender opportunities to foreign bidders. In 2008 and 2009, key mining agreements were negotiated by the government and simply presented to Parliament for quick votes without formal public comment and review.

The U.S. Embassy in Ulaanbaatar and foreign and domestic investors have repeatedly urged the Mongolian government to utilize the government's Open Government web site to post draft and pending legislation for public consultation and review before it is finalized and sent to Parliament. Over the past couple of years, we have noticed some improvement in the timeliness and completeness of the postings.

To supplement this effort, the U.S. Embassy and local business organizations have jointly created an informal system to identify legislation and regulations under review. Once identified, we meet with working groups, provide information on how other nations have handled such legislation, share stakeholders' points of view, and widely distribute publicly available draft bills, preferably before they reach a minister's desk. Should a piece of vital legislation pass on to the Minister, Cabinet, or Parliament, these organizations are prepared to lobby at the appropriate level. Over the last three years we have found that many agencies and Members of Parliament

welcome our advice and information, particularly if given in a non-confrontational way that respects Mongolia's political process and right to deliberate.

Regulators also resist consultation when it comes to implementation. Bureaucrats are only slowly becoming comfortable with the concepts and practices of broad, public consultation and information sharing with their own citizens, let alone foreigners. Many times businesses ask for a clear copy of the current regulations, only to be met with blank stares or outright refusals. The government has acknowledged that the Soviet-era State Secrets Law requires substantial amendment. Currently, most government documents-including administrative regulations affecting investments and business activities-are technically classified and cannot be released to the public. This gives both bureaucrats and regulators a convenient excuse to deny requests for information or, more commonly, to demand extra-legal fees to provide documents. The legacy of secrecy has also resulted in cases where government officials themselves cannot get up-to-date copies of the rules. Mongolia is considering a freedom of information law, but it is only in its formative stages.

High officials acknowledge the value of and need for a more open, transparent system. While laws are easy to fix, the behavior of individual bureaucrats, Members of Parliament, and the judiciary will only gradually change, with training and experience. Already a younger generation of professionals, many trained abroad, is beginning to take hold and to move into senior positions of

authority. This bodes well for Mongolia's continuing transition to a private sector-led, open, market economy underpinned by good government and corporate governance.

The Role of NGOS and Private Sector Associations in relation to FDI

The Mongolian government actively protects its prerogatives to legislate, regulate, and administer economic activities in its domain. While NGOs and private sector associations are given wide latitude to run their activities, the government of Mongolia has never allowed any non-governmental entity-be it business, civil society, trade union, etc.-to have anything more than an advisory role over the formulation and execution of the both laws and rules, which also applies to setting standards for various industries. Based on recent experience, the GOM routinely resists any expanded role for civil society and NGOs. This tacit but unarticulated policy of the government of Mongolia applies to both domestic and foreign entities.

Laws, Regulations, and Policies that Impede FDI

While the GOM supports FDI and domestic investment, individual agencies and elements of the judiciary often reportedly use their respective powers to hinder investments into such sectors as meat production, telecommunications, aviation, or pharmaceuticals. Both domestic and foreign investors report similar abuses of inspections, permits, and licenses by Mongolian regulatory agencies. However, we have noted no consistent, systematic pattern of abuse consistently initiated by either government or private Mongolian entities aimed against foreign investors in general or against US investment in particular. The impediments more often than not are opportunistic attempts by individuals to misuse contacts to harass U.S. and other foreign investors with whom the Mongolian entity is in dispute. Alternatively, other reports suggest that they induce well-placed regulators at all levels to extract extra-legal payments from both foreign and domestic businesses or otherwise hinder their work. In the latter case the general approach is to demand some sort of payment in lieu of not enforcing work, environmental, tax, health and safety rules, otherwise imposing the full weight of a contradictory mix of Soviet Era and the current reformed rules on the firm. Most foreign businesses refuse to pay bribes, and in turn accept the punitive inspections, concede to some of the violations found, and contest the rest in the City Administrative Court. In our experience companies that show resolve against such predatory abuse of statutory and regulatory power will face impediments at the start; but these usually ease over time as state agents look for easier targets.

A.9 EFFICIENT CAPITAL MARKETS AND PORTFOLIO INVESTMENT

Mongolia currently lacks experience and expertise to sustain portfolio investments. It has no regulatory apparatus for these

activities, and both the state and private entities are just beginning to engage in them. However, Mongolia has active capital markets. The Mongolian government imposes few restraints on the flow of capital in any of its markets. Multilateral institutions, particularly the IMF, find the regime too loose, especially in the crucial banking sector. Although the government has clear rules about capital reserve requirements, the Mongol Bank, Mongolia's central bank has historically resisted restraining credit flows at commercial banks. In response to the current global financial crisis, however, Mongol Bank has responded to the decreasing availability of capital and liquidity in Mongolia by tightening reserve requirements and the interest it charges to local banks for funds, and currency controls. That said, most foreign businesses have approved of the ease with which they can access financial resources.

Capital and Currency Markets

Although liquidity is quite high in Mongolia, affordable capital remains scarce. Local credit interest rates for customers range from 12% for the most credit worthy to perhaps 90% per annum (or more) for the least, with inflation peaking at around 40% in 2008

before settling at 24%. Foreign investors can easily tap into domestic capital markets. However, they seldom do, because they can do better abroad or better locally by simply taking on an equity investor, Mongolian or otherwise.

Mongolia's currency, capital, and equity markets took major hits in ¶2008. Over the last three years the currency had proved resilient, holding its value against most international currencies. This resiliency has largely been attributed to the commodities boom, which saw Mongolia selling such raw materials as copper, gold, and coal, primarily to China. In mid 2008, the commodity markets began to cool and Mongolia's foreign trade began to fall, leading to growing trade deficit as imports no longer balanced or exceeded exports. Subsequently, the once strong tugrik has begun to slide and by March 2009 had lost 40 % of its value relative to the U.S. dollar, affecting all import-related trade. Complicating matters, major banks and other institutions that formally had access to international capital flows (in the form of dollars, yen, renmimbi, Euros, etc, which were parked in high-interest yielding tugrik accounts), found international in-flows reversing as foreign depositors repatriated their funds, either because these entities needed the money to weather their own financial crises or they fear that the tugrik's collapse would eat away the value of their deposits. Banks no longer had access to easy capital and liquidity, and began to restrict lending to almost all clients, who in turn found they lacked funds to finance construction projects, trade, and other activities.

After several months of tapping reserves to slow the tugrik's decline, Mongol Bank has curtailed such infusions. Instead, the Bank will sell dollars into the system via an auction to the local commercial banks and will let the market decide the value of the exchange rate rather than attempt to set the rate or artificially support it.

Equity Markets

Investors do not use stocks to raise equity for investment but to gain control of companies listed on the exchange. As most of the firms have been bought up, the market sees little trading.

Mongolian firms do not use shareholding relationships to restrict foreign investment at this point. Part of this arises from lack of experience with such devices. It also arises from the fact that Mongolians prefer to concentrate ownership in their own hands, rather than disperse it through complicated shareholding relationships. They perceive such devices as weakening their ability to control the companies, which is more important than safeguarding the firm from foreign or domestic raiders. If a foreign company wanted to purchase a Mongolian firm, the foreign entity would have to contact the shareholders and buy them out. These could not be hostile takeovers, because few outstanding shares remain on the market to buy. Eager to take on equity partners or sell businesses entirely, the Mongolians would employ few defenses beyond sharp negotiating.

The current Minerals Law of Mongolia recently imposed a provision that requires that holders of mining licenses for projects of

strategic importance must sell no less than 10% of the resulting entity's shares on the Mongolian Stock Exchange. Vaguely presented in the statute, what this new provision means in practical terms and how it is to be implemented has yet to be spelled out in regulation.

The Banking Sector

Weakness in Mongolia's banking sector concerns all players, including the International Monetary Fund (IMF: http://www.imf.org). Small by American standards, the total assets of Mongolia's sixteen (16) banks adds up to just over US$2 billion. The system has been through massive changes since the Soviet era, during which the banking system was divided into several different units. This early system failed through mismanagement and commercial naivety in the mid-90s, but over the last decade has become more sophisticated and

better managed.

Mongolia has three large, generally well-regarded banks owned primarily by Japanese and, Mongolian interests respectively. They follow international standards for prudent capital reserve requirements, have conservative lending policies, up-to-date banking technology, and are generally well managed. If a storm should descend on Mongolia's banking sector, these banks appear well-positioned to weather it.

However, concerns remain among these bankers about the effectiveness of Mongolia's legal and regulatory environment. As with many issues in Mongolia, the problem is not of lack of laws or procedures but the will and capacity of the regulator, Mongol Bank, to supervise and execute mandated functions, particularly in regard to capital reserve requirements and non-performing loans.

From 1999 through late 2008, Mongol Bank had consistently refused to close any private Mongolian bank for insolvency or malpractice. In late 2008, Mongol Bank took Mongolia's fourth largest bank into receivership. Most deposits were guaranteed and their depositors paid out. Mongol Bank survived the crisis, which cost it around US$150 million -- not an inconsequential sum in an economy with a US$5 billion per annum GDP. However, most observers noted that the bank in question had shown signs of mismanagement, non-performing loans, and ill-liquidity several years before the central bank moved to safeguard depositors and the financial sector; and they argued that that Mongol Bank had not shut any bank, fearing that closure would signal weakness to the general public or because regulators within the Mongol Bank, as Mongolia's central bank, have financial interests in the troubled banks that would be threatened by regulatory action. The latest crisis led to a new Mongol Bank governor, and the institution has tightened some but not all of the reserve requirements and formally indicated to banks that it will not indemnify them for deposits they park in any bank which subsequently goes bankrupt.

No accurate figures exist on non-performing loan (NPL) rates. American and foreign bankers and the IMF believe that central bank's methods for tracking NPLs understate the rate, and as such are concerned that several banks may teeter near insolvency.

A.10 POLITICAL VIOLENCE

Mongolia is peaceful and stable. Political violence is rare. Mongolia has held eight peaceful presidential and parliamentary elections in the past 15 years. However, a brief but violent outbreak of civil unrest followed disputed parliamentary elections on July 1, 2008. Accompanied by some property destruction and bodily injury, the unrest was quickly contained and order restored. There has been no repeat of this civil unrest since July 1.

Mongolia has an ethnically homogenous population: 97% of the population is Khalkh Mongol. The largest minority, numbering an estimated 90,000 people, is Kazakh (Muslim), concentrated in the far western part of the country.

There have been no known incidents of anti-American sentiment or politically motivated damage to American projects or installations in at least the last decade. However, there has been a gradual and perceptible level of rising hostility to Chinese and, to a lesser extent, Russian nationals in Mongolia. This hostility has led to some instances of improper seizure of Chinese-invested property; and in more limited cases acts of physical violence against the persons

and property of Chinese nationals resident in Mongolia. Other Asians living in Mongolia have expressed concern that they may inadvertently become victims of this hostility.

A.11 CORRUPTION

In mid 2005, the USAID Mission to Mongolia, in collaboration with USAID/Washington and The Asia Foundation (TAF), funded a corruption assessment conducted by Casals & Associates, Inc. (C&A).(the complete report is available at http://www.usaid.gov/mn). Follow up

surveys of the problem show that the results of this assessment remain valid in 2009. The study found that opportunities for corruption have and continue to increase in Mongolia at both the "petty" or administrative and "grand" or elite levels. Both types of corruption should be of concern to Mongolians, but grand corruption should be considered a more serious one because it solidifies linkages between economic and political power that could negatively impact or ultimately derail democracy and development, as it has in other post-Communist countries. Several inter-related factors contribute to Mongolia's corruption problem:

--A profound blurring of the lines between the public and private sector brought about by endemic and systemic conflict of interest (COI) at nearly all levels;

--A lack of transparency and access to information, stemming in part from a broad State Secrets Law that surrounds many government functions and undermines nearly all aspects of accountability by contributing to an ineffective media and hindering citizen participation in policy discussions and government oversight;

--An inadequate civil service system that gives rise to a highly politicized public administration and the existence of a "spoils system;"

--Limited political will and leadership to actually implement required reforms in accordance with the law, complicated by conflicting and overlapping laws that further inhibit effective policy implementation;

--Weak government control institutions, including the Central Bank, National Audit Office, parliamentary standing committees, Prosecutor General, Generalized State Inspection Agency, State Property Committee, and departments within the Ministry of Finance.

The aforementioned systemic shortcomings have allowed for an evolution of corruption in Mongolia that "follows the money," meaning that graft on the most significant scales generally occurs most often in the industries and sectors where there is the most potential for financial gain. During the early 1990s, opportunities for increased corruption emerged during the transition toward democracy and market economy and process of reconnecting to the international community. Two areas that offered particular opportunities for grand scale corruption at that time were foreign donor assistance and privatization of state-owned enterprises. Later, as Mongolia embarked on further policy changes to install capitalistic practices, corruption reared its head in the process of privatizing public land. Now that most of the small amount of high-value land has been doled out and the overall economy continues expanding, based in part on extractive industries, emerging areas for corruption include the banking and mining sectors. As in many developing countries, there also are several areas that provide stable and consistent opportunities for corruption, both grand and administrative in nature, such as for procurement opportunities, issuance of permits and licenses, customs, inspections, the justice sector, among high-level elected and appointed officials, and in the conduct a variety of day-to-day citizen- and business-to-government transactions, notably in education, health care, and city services.

Despite the fact that few of the conditions to prevent corruption from getting worse are in place, the situation has not reached the levels that are evident in many other countries with contexts and histories similar to that of Mongolia. Perhaps more importantly, there are a number of nascent and rudimentary efforts underway to actively combat corruption, including:

--Government commitments to international anti-corruption regimes and protocols, such as the Anti-Corruption Plan of the Asian Development Bank/Organization of Economic Cooperation and Development (ADB/OECD) and the United Nations Convention Against

Corruption (UNCAC);

--Development of a National Program for Combating Corruption and formation of a National Council for coordinating the Program and a

Parliamentary Anti-Corruption Working Group;

--Implementation of an anti-corruption law that has included the formation of an independent anti-corruption body;

--Short- and medium-term anti-corruption advocacy and "watchdog" programs initiated by civil society organizations, often with international donor support.

There is, in fact, time for Mongolians and the international community to nurture these efforts and take further action before the corruption problem gets out of hand. In general, the main need in Mongolia is for effective disincentives for corrupt behavior at both the administrative and political level. In its broadest configuration, this implies a strategy of increasing transparency and effective citizen oversight, as well as intra-governmental checks and balances. Without these major changes, administrative reforms may provide some small improvements, but they are unlikely to reverse current trends. Specifically, the report makes several strategic recommendations, including:

--Diplomatic engagement focused on keeping anti-corruption issues on the policy agenda, promoting implementation of existing laws related to anti-corruption, and highlighting the need for further measures to promote transparency and improved donor coordination;

--General programmatic recommendations to address conflict of interest, transparency/access to information, civil service reforms, and the independent anti-corruption body, with a definitive focus on engaging civil society and promoting public participation utilizing UNCAC as a framework;

--Specific programmatic recommendations to address loci of corruption, such as citizen- and business-to-government transactions, procurement, privatization, customs, land use, mining, banking, the justice sector, and the political and economic elite

In addition, the reputable international anti-corruption NGO Transparency International (TI) opened a national chapter in Mongolia in 2004. (See: www.transparency.org) U.S. technical advisors are working with TI to train Mongolian staff to monitor corruption and to advocate on behalf of anti-corruption legislation and, TI first included Mongolia in its annual "Perceptions of Corruption" survey in September 2004. In that initial survey, Mongolia ranked 85 out of 145 countries and its score of 3 on the Corruption Perception Index was "poor." (TI's CPI Score relates to "perceptions" of the degree of corruption as seen by business people and country analysts and ranges between 10 (highly clean) and 0 (highly corrupt). TI's 2005 Survey ranked Mongolia 85 out 158; and again Mongolia earned a "poor" score of 3. In TI's 2006 survey, Mongolia had dropped to 99 out of 163 countries, being on par with Mali, Mozambique, and the Ukraine, receiving a score of 2.8-poor. In 2007, Mongolia was still 99 but out of 179 nations and had achieved a score of 3.0, slight uptick but still poor. 2008 saw Mongolia drop to 102 out 180 nations, maintaining its poor score of ¶3. In short, Mongolia has become neither more nor less noticeably corrupt.

2006 Anti-Corruption Law

In 2006, Parliament passed an Anti-Corruption Law (ACL), a significant milestone in Mongolia's efforts against corruption. The legislation had been under consideration since 1999.

The ACL created an independent investigative body, the Independent Authority Against Corruption (IAAC). The IAAC has four sections. The Prevention and Education Section works to prevent corruption and educate the public on anti-corruption legal requirements. The Investigation Section receives corruption cases and executes investigations. The third section collects, checks, and analyzes the legally required property and income statements of government officials. The fourth section, the IAAC's Secretariat, handle s administrative tasks. The IAAC formally began operations in August ¶2007. (For a review of the IAAC's activities from its inception through late 2008 and a general assessment of the public's current views of corruption in Mongolia see the series of Mongolia

Corruption Benchmarking Surveys prepared for USAID Mongolia: http://www.usaid.gov/mn; and The Asia Foundation: http://asiafoundation.org/publications)

U.S. Foreign Corrupt Practices Act (FCPA)

The U.S. Embassy in Ulaanbaatar reminds U.S. entities and citizens active in Mongolia that both they and their agents are subject to the provisions of the FCPA. For information about the FCPA visit the U.S. Department of Justice web site at http://www.usdoj.gov/criminal/fraud/fcpa/.

A.12 BILATERAL INVESTMENT AGREEMENTS

(For Agreement list see UNCTD: http://www.unctad.org)

Taxation issues of Concern to American Investors

Taxation remains an area of key concern for American, other foreign investors, and Mongolian domestic investors and businesses. 2006 saw major reforms of the Mongolian tax system, most of which, with the exception of the windfall profits tax on gold and copper, were greeted positively by most foreign and domestic investor in Mongolia.

Windfall Profits Tax on Copper and Gold

The Windfall Profits Tax Law of 2006 (WPT) drew sharp criticism of the GOM's commitment to creating an open, predictable, fair environment for foreign direct investment. (See Section A.1 for discussion of the WPT.)

Revisions of the Mongolian Tax Code:

Problems with the WPT aside, major reforms to the Mongolian Tax code in 2006 greatly improved the business environment in Mongolia for both foreign and domestic investors. Before the reforms, a World Economic Forum survey of Mongolian business executives cited tax rates and the complexity of tax regulations as two of the top five problems for doing business in Mongolia. The tax reforms benefited from two years of technical assistance from USAID's Economic Policy Reform and Competitiveness Project (EPRC). The reforms affected the Personal Income Tax (PIT) and Corporate Income Tax (CIT) codes as well as the VAT and excise tax codes. (EPRC has a number of useful and informative guides on their website: http://www.eprc-chemonics.biz. See Sections A.1 and A. 5 for description of these tax reforms.)

Unfinished Business (Including Customs Rates)

There is unfinished business, however, as Parliament continues to consider additional tax reform measures. These include revisions to the law on customs and customs tariffs. While the exact natures of the proposed changes in the customs law have been murky, the GOM states that changes will be consistent with Mongolia's WTO obligations and investment climate enhancement goals.

Institutional Impediments Remain a Concern

Despite these solid, positive changes, international financial institutions and other observers warn that these recent legislative changes by themselves are insufficient to improve Mongolia's business environment. Reform efforts need to go beyond changes to the tax code, requiring fundamental reform in how such key agencies as the tax department, the customs administration and the inspections agency directly interact with private firms and individuals.

Specifically, tax authorities charged with enforcing the tax codes require a more customer-based approach to dealing with their business clientele and a more detailed and rigorously enforced regulatory framework under which to audit company accounts. Many foreign and domestic investors argue that the lack of such a clear, implementable code of ethics and enforceable set of guidelines leads to arbitrary, capricious, or predatory tax audits.

A.13 OPIC AND OTHER INVESTMENT INSURANCE PROGRAMS

Recently OPIC (www.opic.gov) has become more active in Mongolia. OPIC has issued and plans to issue direct loans to American firms

providing a variety of services in Mongolia. Loans and political risk insurance to American investors involved the banking, tourism, mining, and equipment sectors are in process. Because the amounts required are relatively small, OPIC seems willing to make direct loans rather than provide loan insurance to projects.

In 2006, the U.S. Export-Import Bank (EXIM) opened in Mongolia for short-, medium-, and long-term transactions in the public sector and for short- and medium-term transactions in the private sector. (www.exim.gov).

Mongolia is a member of the Multilateral Investment Guarantee Agency (MIGA: www.miga.org).

¶A. 14 LABOR

The Mongolian labor pool is generally well educated, relatively young, and adaptable, but shortages exist in most professional categories requiring advanced degrees or training. Only time and investment in education and training will remedy this deficit of trained skilled labor. Unskilled labor is sufficiently available. Shortages exist in both vocational and professional categories because Mongolians who obtain such skills frequently go abroad to find higher wages. Why stay in Mongolia if one cannot recover the outlay on the training from a Mongolian-based job? Foreign invested companies are dealing with this situation by providing in-country training to their staffs, raising salaries to retain employees, or hiring expatriate workers to perform functions not available locally. In addition, the USG funded Millennium Challenge Corporation (MCC) is underwriting a five-year training and vocational education program (TVET) to develop sustainable programs to help Mongolia meet its needs for skilled blue- collar workers (http://www.mca.mn or http://www.mcc.gov).

Mongolian labor law is not particularly restrictive. Investors can locate and hire workers without using hiring agencies -- as long as hiring practices are consistent with Mongolian Labor Law. However, Mongolian law requires companies to employ Mongolian workers in certain labor categories whenever a Mongolian can perform the task as well as a foreigner. This law generally applies to unskilled labor categories and not areas where a high degree of technical expertise nonexistent in Mongolia is required. The law does provide an escape hatch for all employers. Should an employer seek to hire a non-Mongolian laborer and cannot obtain a waiver from the Ministry of Labor for that employee, the employer can pay a fee of US$140.00 per employee per month. Depending on a project's importance, the Ministry of Labor can exempt employers from 50% of the waiver fees per worker.

Foreign and domestic investors consistently argue that they bear too much of the social security costs for each domestic and foreign hire under the amended 2008 Social Insurance Law enacted in July 2008. Foreign employees became liable for social insurance taxes if they reside within Mongolia for 181 days within a 365 day period. Under this law, foreign and domestic workers pay up to 108,000 tugrik (US$ 67) for this tax, no matter their respective rates of pay. Employers must pay a tax equivalent to 13% of the annual wage on both domestic and foreign workers. Given that state pensions have yet to broach even US $100, Employers argue that pensions are not commensurate with worker contributions, especially those of highly-paid ex-patriot employees. In addition, workers must pay in for twenty years in order to be vested, highly unlikely for many ex-patriot employees, who reside in Mongolia for less than three years on average. Local and foreign business associations are working with both the government/Parliament to address perceived inequities.

Regarding ILO conventions See ILO at http://www.ilo.org

¶A. 15 FOREIGN TRADE ZONES/FREE PORTS

The Mongolian government launched its free trade zone (FTZ) program in 2004. Currently there are two FTZs located along the Mongolia spur of the trans-Siberian highway: one in the north at the Russia-Mongolia border town of Altanbulag and the other in the south at the Chinese-Mongolia border at the town of Zamyn-Uud. Both FTZs appear moribund, with no development at either site. The port of entry of Tsagaan Nuur in Bayan-Olgii province is being considered as the site of third FTZ.

Management for the Zamyn-Uud Free Trade Zone (ZUFTZ) was originally tendered to a Chinese firm. In 2006, the GOM voided the agreement for non-compliance of the terms of the tender. The GOM re-tendered the management contract in 2006, but later voided the contract, alleging that the current holder of the management rights in the ZUFTZ had failed to live up to the terms of the tender.

So far, there are no indications that government will not keep promises to open the zone to any who satisfy the relevant legal requirements. However, there are concerns about the Mongolian free trade zones in general and Zamyn-Uud in particular. In April 2004, the USAID sponsored Economic Policy Reform and Competitiveness Project (EPRC: http://www.eprc-chemonics.biz/) made the following observations of Mongolia's FTZ Program. In 2009, these issues remain concerns:

--Benchmarking of Mongolia's FTZ Program against current successful international practices shows deficiencies in the legal and regulatory framework as well as in the process being followed to establish FTZs in the country.

--Lack of implementing regulations and procedural definitions encapsulated in transparency and predictability quotient required to implement key international best practices.

--A process of due diligence, including a cost-benefit analysis, has not been completed for the proposed Zamyn-Uud FTZ.

--Identifiable funding is not in place to meet off-site infrastructure requirements for Zamyn-Uud and Altanbulag sites.

--Deviations from international best practices in the process of launching FTZs risks repeating mistakes made in other countries and may lead to "hidden costs" or the provision of subsidies that the government of Mongolia did not foresee or which will have to granted at the expense of other high priority needs

¶A. 16 FOREIGN DIRECT INVESTMENT STATISTICS:

Comment on the data sources for foreign direct investment in Mongolia. The Foreign Investment and Foreign Trade Agency (FIFTA) provides most of the data for tracking FDI in Mongolia. However, the data has limitations:

¶A. Incomplete reporting and data collection:

--Many foreign firms provide FIFTA with inaccurate or incomplete data on their annual investment amounts. FIFTA's registration regime requires companies to document business plans and total FDI for the coming year. FIFTA uses these amounts to determine FDI for the year. However, firms reportedly believe FIFTA may not be able to guarantee the confidentiality of proprietary business information, and so they withhold complete data on their actual activities.

--Mongolia also suffers from promised investment that does not materialize or which comes in at a lower level than originally stated. FIFTA does not update reports to account for these or other changes to investments during the year. (See Chapter 6, Section A.5: Performance Requirements and Incentives).

--In addition, many of Mongolia's largest foreign- owned or foreign-invested entities are in the mining sector, which because of a quirk of the current Minerals Law of Mongolia are not necessarily

defined as foreign-invested firms. The current minerals law specifies that only domestically registered mining firms can have mining licenses registered in their names, which means that foreign investments associated with mining may not be recorded by FIFTA, even though the investment is demonstrably foreign. For example, the investment by Ivanhoe Mines Mongolia (a Canadian company) into Mongolia has reached at least US$ 800 million, yet this investment is not recorded among the data provided by FIFTA.

¶B. Data not Available: Neither FIFTA nor any other Mongolian agency to our knowledge tracks Mongolia's direct investment abroad.

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